

**IN THE CHANCERY COURT FOR LEWIS COUNTY, TENNESSEE
AT HOHENWALD**

In re: Sentinel Trust Company

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Case No. 4781

**MEMORANDUM IN SUPPORT OF MOTION OF
POPLAR GROVE UTILITY DISTRICT TO INTERVENE
AND TO TRANSFER ESCROW ACCOUNTS TO A NEW ESCROW AGENT**

Poplar Grove Utility District of Tipton County, Tennessee (Poplar Grove) has five (5) escrow accounts with Sentinel Trust Company (STC). In addition, STC also holds books and records relating to Poplar Grove's bond issuances. Poplar Grove's escrow accounts are invested in a U.S. Treasury Bill maturing on October 28, 2004. STC was placed in liquidation June 18, 2004, by action of the Tennessee Commissioner of the Department of Financial Institutions. Poplar Grove seeks an order from this Court directing the Liquidator for STC to transfer the escrow accounts and the books and records relating to Poplar Grove's bond issuances to Wachovia Bank, National Association.

I. FACTS

Poplar Grove has five (5) escrow accounts with STC. Three of the escrow accounts are Debt Service Reserve Accounts that were created in relation to revenue bonds Poplar Grove sold to support capital improvements to its water systems and gas system. The terms of the bond issuances require that certain sums be set aside as Debt Service Reserve Funds to be available if the revenues from the operations of Poplar Grove are insufficient to meet the debt requirements

of the bond issuances. These Debt Service Reserve Funds are required to be kept separately and used solely for the purpose of paying principal and interest on the bonds. Failure to maintain the Debt Service Reserve Funds would place Poplar Grove in default of its bond issuances.

The other two escrow accounts are an Operating Account and a Deposit and Refund Account. The bond issuances and the five escrow accounts are described below.

Debt Service Reserve Fund Accounts

Two of the three Debt Service Reserve Funds (Accounts # 573313041 and # 573313051) relate to Waterworks Revenue Refunding Improvement Bonds, Series 2001 issued in the amount of \$720,000 pursuant to a resolution adopted on January 23, 2001 supplementing and amending a resolution adopted on July 7, 1998, and Waterworks Revenue Refunding Bonds, Series 2002 issued in the amount of \$3,165,000 pursuant to a resolution adopted on November 27, 2001, supplementing the resolutions adopted July 7 1992 and January 23, 2001. These Bonds will be collectively referred to herein as the "Waterworks Bonds." The Resolutions adopted by the Board of Commissioners authorizing issuance of the Waterworks Bonds require that funds in the amount of the Reserve Fund Requirement be deposited into a separate fund called the "Debt Service Reserve Fund." Section 9(d) of the Resolutions.¹

Section 9.3. Reserve Fund. of the Arbitrage Certificate for the Series 2002 Bonds sets the Debt Service Reserve Fund for the Waterworks Bonds at \$458,161.00.² Accounts # 573313041 and # 573313051 are the Debt Service Reserve Funds established for the Waterworks Bonds pursuant to the Resolutions and reflected in the Arbitrage Certificate. These escrow accounts are listed in Exhibit A to Vivian Lamb's Affidavit, submitted as Exhibit 1 to Receiver's Motion for

¹ These resolutions are attached as Exhibit 1 to Poplar Grove's Motion to Intervene and to Transfer Escrow Accounts to a new Escrow Agent (Motion to Intervene). All exhibits to the Motion to Intervene are attested to by Karen Neal, Exhibit 6.

² The first page and Section 9.3 of the Arbitrage Certificate is attached as Exhibit 2 to the Motion to Intervene.

approval of Transfer of Pre-May 18th Fiduciary Investment Accounts when Successor Paying Agent or Trustee is Appointed.³ These escrow funds are invested in a U.S Treasury Bill maturing on October 28, 2004.

The third of the three Debt Service Reserve Funds (Account # 57331303144724010) relates to Gas System Revenue Refunding Bonds, Series 1998A in the amount of \$3,845,000. These bonds will be referred to herein as the "Gas System Bonds." The Resolution adopted by the Board of Commissioners of the District authorizing the issuance of the Gas System Bonds⁴ requires that funds in the amount of the Reserve Fund Requirement be deposited into a separate fund called the "Debt Service Reserve Fund." Section 8 of the Resolutions.⁵

Page 6 of the Arbitrage Certificate for the Series 1998A Bonds sets the Debt Service Reserve Fund at \$386,226.25.⁶ Account # 57331303144724010 is the Debt Service Reserve Fund established for the Gas System Bonds pursuant to the Resolution and reflected in the Arbitrage Certificate. This escrow account is listed in Exhibit A to Vivian Lamb's Affidavit, Exhibit 3 to the Motion to Intervene. This escrow fund is invested in a U.S Treasury Bill maturing on October 28, 2004.

Operating Account and Deposit and Refund Account

Poplar Grove has two additional accounts with STC. One is Operating Account #573313000 and the other is a Deposit and Refund Account #573313007. These accounts, like the others are held in a U.S. Treasury Bill maturing October 28, 2004. See affidavit of Vivian Lamb, Exhibit 3 to Motion to Intervene.

³ A copy of Ms. Lamb's Affidavit is attached as Exhibit 3 to the Motion to Intervene.

⁴ Portions of the Resolution are attached as Exhibit 4 to the Motion to Intervene.

⁵ These resolutions are attached as Exhibit 1 to Poplar Grove's Motion to Intervene and to Transfer Escrow Accounts to a new Escrow Agent (Motion to Intervene). The exhibit is attested to by Karen Neal, Exhibit 6.

⁶ The first and sixth pages of the Arbitrage Certificate are attached as Exhibit 5 to the Motion to Intervene.

Regarding All Accounts

The above five escrow accounts are held in the same U.S. Treasury Bill maturing October 28, 2004. Each account is accounted for separately. *Id.* By Resolution adopted July 27, 2004⁷, Poplar Grove terminated STC and designated Wachovia Bank, National Association, as its Successor Agent and requested that all funds be transferred to its Successor Agent.

II. LAW AND ARGUMENT

A. DEBT SERVICE RESERVE FUND ACCOUNTS

1. The Poplar Grove Debt Service Reserve Fund Accounts Are Not Part of STC's Estate and May Not Be Used for Any Purpose Other Than to Pay the Holders of the Waterworks Bonds and the Gas System Bonds

STC holds the Poplar Grove Debt Service Reserve Fund Accounts in trust for the benefit of the holders of the Waterworks Bonds and the Gas System Bonds. A valid and enforceable express trust exists where the following elements are present: 1) a trustee who holds trust property and who is subject to the equitable duties to deal with it for the benefit of another, 2) a beneficiary to whom the trustee owes the equitable duties to deal with the trust property for his benefit, and 3) identifiable trust property. *Kopsom-but-Myint Buddhist Center v. State Board of Equalization*, 728 S.W.2d 327, 333 (Tenn. App. 1986); *Stevenson v. J.C. Bradford & Company*, 277 F.3d at 850 (applying Tennessee law).

The Resolutions adopted by the Board of Commissioners of the District on July 7, 1992, January 23, 2001 and November 27, 2001 authorizing the issuance of the Waterworks Bonds require that funds in the amount of the Reserve Fund Requirement be deposited

into a separate and special fund, to be known and designated as "Debt Service Reserve Fund", to be kept separate and apart from all other funds of the District.
... Money in the Reserve Fund shall be used solely for the purpose of paying

⁷ The Resolution is Exhibit 7 to the Motion to Intervene.

principal . . . of or interest on the Bonds and any Parity Bonds for the payment of which funds are not available in the Bond Fund.

(Section 9(d) of the Resolutions adopted on July 7, 1992, as amended and supplemented by the Resolutions adopted on July 23, 2001 and November 27, 2001.⁸)

Section 9.3 of the Arbitrage Certificate for the for the Series 2002 Bonds sets the debt service reserve fund for the Waterworks Bonds at \$458,161.00.⁹ This Section also states:

9.3. Reserve Fund. The Debt Service Reserve Fund (the "Reserve Fund") is established pursuant to Section 9(c) of the Resolution (July 7, 1992) and will be funded a portion of the amounts currently in the Reserve Fund for the Refunded Bonds to the Reserve Fund Requirement. The Reserve Fund is established to maintain a reasonable reserve fund to pay debt service in the event the Bond Fund is inadequate for that purpose in any Bond year. Any funds in the Reserve Fund are reserved for the payment of the 2001 Bonds, the Bonds and any bonds hereafter issued on a parity therewith and shall be used for no other purpose so long as any of such Bonds and parity bonds are outstanding. Any amount received from investment of funds in the Reserve Fund shall be regarded as revenues of the System and applied in the same manner as other revenues of the System.

* * * *

The Resolution adopted by the Board of Commissioners of the District authorizing the issuance of the Gas System Bonds¹⁰ states in part in *Section 8. Application of Revenues.* (d) as follows:

. . . the next available money in the Revenue Fund shall be used to make deposits into a separate and special fund, to be known and designated as "Debt Service Reserve Fund", to be kept separate and apart from all other funds of the District. . . . Money in the Reserve Fund shall be used solely for the purpose of paying principal of or interest on the Bonds and any Parity Bonds for the payment of which funds are not available in the Bond Fund.

* * * *

⁸ These resolutions are attached as Exhibit 1 to Poplar Grove's Motion to Intervene and to Transfer Escrow Accounts to a new Escrow Agent (Motion to Intervene). The exhibit is attested to by Karen Neal, Exhibit 6.

⁹ The first page and Section 9.3 of the Arbitrage Certificate is attached as Exhibit 2 to the Motion to Intervene.

¹⁰ Portions of the Resolution are attached as Exhibit 4 to the Motion to Intervene.

Page 6 of the Arbitrage Certificate for the Series 1998A Bonds sets the debt service reserve fund at \$386,226.25.¹¹ The Arbitrage Certificate, Section 8.1(a)(ii)(A), page 5, states:

The Debt Service Reserve Fund (the "Reserve Fund") is established pursuant to Section 8(c) of the Resolution. The Reserve Fund is established to maintain a reasonable reserve fund to pay debt service in the event the Bond Fund is inadequate for that purpose in any bond year. The money in the Reserve Fund is reserved for the payment of the Series 1998A Bonds or Parity Bonds, and shall be used for no other purpose so long as any of the Series 1998A Bonds or Parity Bonds are outstanding. Any amount received from investment of funds in the Reserve Fund shall be regarded as revenues of the System and applied in the same manner as other revenues of the System.

* * * *

The above Section of the Arbitrage Certificate is filed herewith and identified as Exhibit 8 in order to preserve the exhibit numbering scheme from the Motion to Intervene.

STC holds the Poplar Grove Debt Service Reserve Fund Accounts for the benefit of the Poplar Grove bondholders. It is clear from these documents that STC was required to escrow the funds received from Poplar Grove, and to use the funds only to pay interest and principle on the bonds and parity bonds. It is also clear that the funds were properly segregated and are clearly identifiable. The affidavit of Vivian Lamb, Trust Administrator for the Trust Examination Division of the Tennessee Department of Financial Institutions, confirms that the funds are separately identified on the books of STC. Motion to Intervene, Exhibit 3, ¶ 3.

All elements of an express trust are present with respect to the Debt Service Reserve Fund Accounts. Accordingly, STC is trustee of the Poplar Grove Debt Service Reserve Fund Accounts. See *Kopsom-but-Myint Buddhist Center v. State Board of Equalization*, 728 S.W.2d 327, 333 (Tenn. App. 1986) (defines trust); *Stevenson v. J.C. Bradford & Company et al. (In re Cannon)*, 277 F.3d 838, 850 (6th Cir. 2002) (defines express trust under Tennessee law).

¹¹ The first and sixth pages of the Arbitrage Certificate are attached as Exhibit 5 to the Motion to Intervene.

When property is placed in escrow or in trust, the escrow agent or trustee holds legal title to the property; however, equitable title remains vested in the grantor until the happening of a condition or contingency triggering either the dissolution of the trust/escrow and return of the corpus to the grantor or the transfer of equitable title to the beneficiary. *See, e.g., Begier v. Internal Revenue Serv.*, 496 U.S. 53, 110 S.Ct. 2258, 2263, 110 L.Ed.2d 46 (1990); *Stevenson v. J.C. Bradford & Company et al. (In re Cannon)*, 277 F.3d 838, 850-852 (6th Cir. 2002); *Old Republic National Title Insurance Company v. Tyler*, 206 B.R. 394, 402 (E.D. Va. 1997). Since equitable title to property held in escrow or trust does not pass to the trustee/escrow agent, funds held in escrow by a debtor in liquidation are not part of the debtor's estate. *See, e.g., Begier v. Internal Revenue Serv.*, 110 S.Ct. at 2263 (Because debtor in bankruptcy does not own an equitable interest in property that he holds in trust for another, that property is not property of the debtor's bankruptcy estate.); *Stevenson v. J.C. Bradford* at 850-852 (Applying Tennessee law, the Court found that funds the debtor held in escrow did not become part of the debtor's bankruptcy estate.) *Old Republic National Title Insurance Company v. Tyler*, 206 B.R. at 402 (To the extent traceable, funds held in escrow by debtor were not part of debtor's bankruptcy estate.).

Stevenson v. J.C. Bradford involved a debtor in Chapter 7 bankruptcy who, prior to the bankruptcy, had misappropriated funds from an escrow account held for another person. The debtor had deposited his own personal funds into the account in an effort to repay some of the misappropriated funds. The Chapter 7 trustee sought to use his statutory avoidance power to recover funds transferred from the escrow account. The 6th Circuit Court of Appeals refused to allow it even though the debtor had deposited his own personal funds into the account. Applying Tennessee law, the Court found that funds the debtor held in escrow did not become part of

debtor's bankruptcy estate because the debtor possessed only legal title to funds and not equitable title. The commingling of his own funds did not result in any portion of the escrow becoming part of his estate as the deposits were merely restitution for misappropriated funds.

Like the debtor in *Stevenson v. J.C. Bradford*, STC holds legal but not equitable title to the escrowed Poplar Grove Debt Service Reserve Fund Accounts. As such, the funds are not part of STC's estate. STC has no right to dispose of the Poplar Grove Debt Service Reserve Fund Accounts other than by paying the bondholders as provided in the Resolutions adopted by the Board of Commissioners authorizing issuance of the Waterworks Bonds and the Gas System Bonds and Arbitrage Certificates associated with each issuance.

2. The Poplar Grove Debt Service Reserve Fund Accounts Must Be Transferred To A Successor Escrow Agent

State law governing the liquidation of financial institutions, including STC, requires the Commissioner of the Department of Financial Institutions to promptly terminate the fiduciary responsibilities of a financial institution placed in liquidation, and it provides for the appointment of a successor fiduciary. Tennessee Code Annotated § 45-2-1504(c) provides that:

As soon after the commencement of liquidation as is practicable, the commissioner shall take the necessary steps to terminate all fiduciary positions held by the state bank and take such action as may be necessary to surrender all property held by the bank as a fiduciary and to settle its fiduciary accounts. Such fiduciary accounts may be transferred by the commissioner to another qualified corporate fiduciary as determined by the commissioner, and notice of such transfer must be given by registered mail to the parties by the transferee corporate fiduciary.

By Resolution adopted July 27, 2004¹², Poplar Grove terminated STC and designated Wachovia Bank, National Association, as its Successor Agent and requested that all funds be transferred to its Successor Agent.

B. OPERATING ACCOUNT AND DEPOSIT AND REFUND ACCOUNT

The Operating Account and the Deposit and Refund Account are specially designated escrow accounts invested in the same U.S. Treasury Bill as the Debt Service Reserve Accounts. No written document describes the terms of the trust arrangement; however, under Tennessee law, a trust need not be memorialized in writing. The establishment of an oral trust requires proof of the same elements as an express trust; however, proof of the trust must be established by "greater than a preponderance of the evidence." *Emerson v. Marty (In re Mark Benskin & Co., Inc.)*, 135 B.R. 825, 833 (W.D. Tenn. 1991) (applying Tennessee law). Applying Tennessee law, the Court in *Emerson* found that an oral trust existed, to the extent funds were traceable, where an investor had deposited money with an unlicensed investment advisor for purposes of making an investment, even though the advisor made no such investment and commingled the funds with his own and those of other "investors." The Court placed significant emphasis on the intent of the parties:

If the intention is that the money shall be kept or used as a separate fund for the benefit of the payor or a third person, a trust is created. If the intention is that the person receiving the money shall have the unrestricted use thereof, being liable to pay a similar amount whether with or without interest to the payor or to a third person, a debt is created.

Emerson v. Marty, 135 B.R. at 834 (citations omitted).

Like the Debt Service Reserve Accounts, the Operating Account and the Deposit and Refund Account are trust accounts. Poplar Grove's intent that STC keep the funds in a separate

¹² The Resolution is Exhibit 7 to the Motion to Intervene.

fund for the benefit of Poplar Grove is evident in the manner in which STC handled the funds. The Trust Administrator for the Trust Examination Division of the Tennessee Department of Financial Institutions has confirmed that the funds are separately identified on the books of STC. Motion to Intervene, Exhibit 3, ¶ 3. Clearly, the funds are segregated and cannot be used by STC. Accordingly, these funds are not part of STC's estate and should be transferred to a new escrow agent.

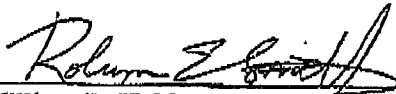
III. CONCLUSION

For the foregoing reasons, Poplar Grove respectfully requests the Court to order the Receiver to transfer the debt service reserve fund accounts and all funds, books and records relating to these bond issuances to Wachovia Bank, National Association. Poplar Grove further requests pursuant to Rule 62.01 of the Rules of Civil Procedure, that the Order not be stayed after entry.

Respectfully submitted,

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